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SUBJECT: SERBIA: PRIVATIZATION AND CORPORATE RESTRUCTURING MOVING
FORWARD

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SUMMARY

¶1. On August 28, the Embassy met with Branislav Zec, Executive Director of Serbia's Privatization Agency (PA). He offered details into the PA's handling of the privatization and restructuring process for the more than 800 small and medium-sized public enterprises remaining in Serbia. These firms are to be either successfully sold off to investors, liquidated, or moved into bankruptcy. Political uncertainty has affected the big companies and tenders, while the impact on the sell-off process for smaller firms appeared more limited. Zec expressed confidence that the PA would adhere to the legislative deadline of December 31, 2008 to set in motion procedures for all socially-owned companies. End Summary.

MANAGING THE PROCESS

¶2. Embassy econoffs met with Branislav Zec, Executive Director of the Privatization Agency (PA), which falls under the authority of the Ministry of Economy and Regional Development. The PA is in charge of removing the approximately 800 remaining socially-owned and state-owned firms from the state's books. These companies are the small and medium-sized enterprises of Serbia's public sector. Zec elaborated that the banks and insurance firms fell outside the PA's direct purview, while the large state-owned enterprises (e.g., JAT (airline), NIS (oil), Telekom Srbija, Galenika (pharmaceuticals), etc.) were managed with significant oversight from the cabinet and the ministries. The PA evaluated which companies were successful enough to try to sell and which were meant to be liquidated or moved into bankruptcy, whereby a company's assets were distributed to its creditors. According to the PA's data, from 2002 through 2007, 2,161 public firms with 334,453 employees have been sold for about $3.5 billion, with an additional $1.5 billion in further investments, and $350 million in social compensation.

RESTRUCTURING THE CORPORATE SECTOR

¶3. The firms are either sold to investors through auctions or tenders (with the large majority being auctioned off), liquidated, or moved into bankruptcy The liquidations occur when a firm's assets exceed its liabilities, with creditors obtaining the assets and perhaps some shareholders receiving any residual capital, a process that takes about 120 days to settle. Bankruptcy proceedings are initiated when a firm's liabilities fell short of its assets. According to Zec, settling bankruptcy claims among creditors took years in the courts. Since 2005, new bankruptcy regulations stipulated that the PA administer the proceedings with court supervision, which has "reduced the time to one to two years."

¶4. For 2008 Zec told us that 482 enterprises were slated for sale via auctions or tenders, and 344 enterprises were to be liquidated or moved into bankruptcy. Past experience suggested that approximately 70% of firms slated for sale were sold successfully to investors, while 30% had to be ultimately liquidated, according to Zec. This implied that around 340 of the 482 firms would be sold to investors (typically Serbian firms) this year. One hundred twenty enterprises had already been offered for sale (100 through auctions, 20 through tenders), with the expectation that up to 250 more would be sold in 2008.

¶5. The PA and the Economy Ministry monitored the performance of the firms that had been sold, mainly to ensure that investment pledges were maintained. Zec told us that usually the privatized firms invested in capacity and laid off employees, which raised productivity. If investment pledges were not fulfilled, the PA canceled the privatization contract, and the firm's shares wound up in the Share Fund, a portfolio of the state's stock holdings in domestic enterprises. Zec said that there was 10%-15% cancellation rate for sales contracts; the Share Fund's managers would subsequently try to sell a firm's shares in the stock market.

POLITICAL UNCERTAINTY AN ISSUE, BUT NOT TOO PROBLEMATIC

¶6. When asked whether political uncertainty affected the PA's work, Zec said that tenders, which were far fewer in number, and the large state-owned enterprises were affected more than auctions. Because investors understood that the privatization process was coming to an end, the sales rate had actually increased over the last one and a half years. The PA's annual sales data is consistent with Zec's claim. The PA sold 328 firms in 2005, 308 in 2006, and 404 firms in

2007, which are noteworthy figures given the political turbulence in
¶2007. The apparently slower pace of sale during the earlier part of this year suggests, however, that the turmoil from multiple elections and Kosovo's declaration of independence had some impact on the PA's auctions.

A WORD ON THE BIG ENTERPRISES

¶7. Zec also offered a few comments on the copper mining complex RTB Bor, JAT Airways, and upcoming tenders. The search for a strategic partner for RTB Bor was ongoing, as the PA in July had given prospective investors until September 30 to submit letters of interest in establishing a partnership with Bor. The partner was to make investments, pay off Bor's commercial creditors (a total of $195 million), obtain management rights, receive a 51% stake in Bor, and co-own the complex with the government, which was converting Bor's debt to the state into equity. Zec claimed that this model for selling Bor was more investor-friendly, as the strategic investor would only have to assume Bor's commercial debts and make investments, instead of purchasing the entire complex and assuming all its liabilities. The state had the advantage of maintaining 49% percent of the shares, whose value presumably would increase and could be sold off later on with the improvement in Bor's performance and profitability. On JAT, Zec was "not too optimistic" as investors had not shown much interest in acquiring the troubled air carrier (Note: this is separate from the tender for aircraft maintenance company Jat Tehnika, for which the PA invited bids in mid-June and for which the Serbian Consul General in Chicago is encouraging a Chicago-based firm to make an offer. End note). The PA would also offer a tender for an advisor to the privatization of pharmaceutical giant Galenika either later this year or in the first quarter of 2009.

COMMENT

¶8. Zec appeared confident that the Privatization Agency would be able to meet the legislative deadline to initiate the privatization and restructuring process for all remaining small and medium-sized public enterprises by the end of 2008. He estimated that the

remaining auctions, tenders, and liquidations would be wrapped up by mid-2009. Renewed investor confidence in Serbia should advance the process, which will boost Serbia's private sector. It also bears reminding that utilities and infrastructure assets remain on the government's books (e.g. EPS (electricity), the railways) and therefore continue to weigh on the government's shaky fiscal position. Completing the sell-off process for all but the largest enterprises would be an important achievement and would be an area where the government actually lived up to one of its promises, and even then in the midst of tumultuous political circumstances. But it would still be only one part of heavy economic agenda that includes reducing unemployment, becoming a magnet for greater greenfield investment, upgrading key roads and infrastructure, and streamlining existing business regulations. End Comment.

MUNTER